

Message Text

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INFO OCT-01 ISO-00 SSO-00 /026 W
-----085500 281024Z /10
O 280928Z APR 78
FM AMEMBASSY TOKYO
TO SECSTATE WASHDC IMMEDIATE 7543

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E.O. 11652: GDS
TAGS: ECON, OCON
SUBJECT: BONN SUMMIT PREPARATIONS

REF: TOKYO 07370

1. SUMMARY: THIS MESSAGE TRANSMITS TEXT OF JAPANESE STATEMENT FOR SCHULTZE GROUP PROMISED BY ECONOMIC PLANNING AGENCY COORDINATION BUREAU DIRECTOR GENERAL MIYAZAKI (REFTEL). TRANSLATION AND TYPING TOOK A LITTLE LONGER THAN ANTICIPATED. END SUMMARY.
QUESTION: WHAT IS YOUR ASSESSMENT OF THE ECONOMIC SITUATION HALFWAY THRU 1978? AND WHAT IS THE OUTLOOK FOR SECOND-HALF 1978 AND 1979?

ANSWER:

1. RECENT ECONOMIC TRENDS.

LOOKING AT RECENT ECONOMIC TRENDS, THE ACCELERATED IMPLEMENTATION OF PUBLIC WORKS AND OTHER PROJECTS SINCE EARLY
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IN JFY 77 (BEGINNING APRIL 1, 1977) AND THE TWO SUPPLEMENTAL BUDGETS HAVE BEGUN TO HAVE EFFECT THROUGHOUT THE ECONOMY. INVENTORY ADJUSTMENT IS PROCEEDING APACE AND PRODUCTION AND SHIPMENTS LEVELS ARE UP FOR CONSTRUCTION MATERIALS AND OTHER SECTORS. THINGS ARE ALSO LOOKING BRIGHTER IN SUCH PRIVATE-SECTOR INDICATION AS PERSONAL CONSUMPTION, PRIVATE HOUSING INVESTMENT, AND PRIVATE PLANT

INVESTMENT, AND IT IS EXPECTED THAT THESE TRENDS WILL CONTINUE UPWARD. ACCORDINGLY, THE ECONOMY SEEMS ON THE ROAD TO RECOVERY, WITH THINGS GOING PRETTY MUCH AS ANTICIPATED BY THE GOVT.

2. THE ECONOMY IN JFY 78.

(1) IN JFY 78 RUNNING FROM APRIL 78 THRU MAR 79, A WIDE VARIETY OF FISCAL AND FINANCIAL MEASURES ARE TO BE IMPLEMENTED, INCLUDING AMBITIOUS EXPANSION OF PUBLIC WORKS INVESTMENTS, CONCENTRATING THESE INVESTMENTS EARLY IN THE YEAR, AND LOWERING INTEREST RATES, SUCH THAT IT IS ANTICIPATED THERE WILL BE STRONG LEVELS OF PUBLIC WORKS AND PRIVATE HOUSING INVESTMENT IN THE FIRST HALF OF THE YEAR WITH STEADY PROGRESS IN INVENTORY ADJUSTMENT. AS THESE EFFORTS HAVE AN INCREASING IMPACT ON THE PRIVATE SECTOR, IT IS EXPECTED THE ECONOMY WILL GROW STEADILY AND STRONGLY.

(2) IN THE SECOND HALF OF THE YEAR, AS THE IMPACT OF THESE POLICY EFFORTS MAKES ITSELF FELT THROUGHOUT THE ECONOMY, IT IS EXPECTED THAT THERE WILL BE OVERALL ECONOMIC RECOVERY, WITH GOOD RECOVERY IN PRIVATE-SECTOR DEMAND INCLUDING (A) STEADY EXPANSION IN PERSONAL CONSUMPTION OUTLAYS AS CONSUMER ATTITUDES TAKE A TURN FOR THE BETTER AS A RESULT OF EXPANDED PERSONAL INCOME, LESSENERD FEARS ABOUT THE FUTURE, AND OTHER POSITIVE DEVELOPMENTS, (B)

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ACCELERATED GROWTH IN PRIVATE PLANT INVESTMENT AS THE ELECTRICAL POWER AND OTHER NON-MANUFACTURING INDUSTRIES PUSH AHEAD FIRMLY WITH THEIR INVESTMENT PLANS AND AS INVESTMENT IS ALSO EXPECTED TO SHOW SOME PICKING UP IN MANUFACTURING INDUSTRIES AS A RESULT OF RECOVERY IN CAPACITY UTILIZATION RATE AND OF IMPROVEMENT IN BUSINESS MIND ON INVESTMENT, AND (C) SOME IMPROVEMENT IN PRIVATE INVENTORY INVESTMENT AS INVENTORY ADJUSTMENTS ARE COMPLETED AND DEMAND PICKS UP.

WITH ECONOMIC TRENDS GOING AS OUTLINED, THE FIRST HALF OF JFY 78 CENTERING UPON GOVT-LED RECOVERY AND THE SECOND HALF UPON PRIVATE SECTOR DEMAND RECOVERY FOR A SMOOTH RECOVERY PROCESS, IT IS EXPECTED THAT GNP GROWTH FIGURES WILL BE VIRTUALLY BALANCED FOR THE FIRST AND SECOND HALVES OF THE YEAR. ALTHOUGH THE FORECAST GROWTH RATE FOR JFY 77 IS SLIGHTLY OVER 5 PCT, THAT FOR JFY 78 IS ABOUT 7 PCT. MOREOVER, ALTHOUGH FORECASTS BY PRIVATE INSTITUTIONS HAVE GENERALLY BEEN LOWER THAN GOVERNMENTAL FORECASTS, AN INCREASING NUMBER OF THESE HAVE RECENTLY BEEN REVISED UPWARD.

3. THE ECONOMY IN JFY 1979.

ALTHOUGH THERE ARE A GREAT MANY UNCERTAIN FACTORS SUCH AS INTERNATIONAL ECONOMIC TRENDS AND OTHERS WHICH MAKE IT MOST DIFFICULT TO PREDICT THE JFY 79 ECONOMIC SITUATION WITH ANY DEGREE OF CERTAINTY, THE FOLLOWING DEVELOPMENTS ARE GENERALLY ANTICIPATED.

PRIVATE PLANT INVESTMENT IS EXPECTED TO GROW STILL STRONG-ER AS THE RECOVERY OF STABILITY IN PRIVATE-SECTOR DEMAND IS JOINED BY HIGHER OPERATING RATIOS, PROGRESS IN CAPITAL STOCK ADJUSTMENT, AND LIKE FACTORS. WITH THIS

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INFO OCT-01 ISO-00 SSO-00 /026 W
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ACTIVATION OF THE ECONOMY, PERSONAL CONSUMPTION OUTLAYS AND PRIVATE HOUSING INVESTMENT ARE ALSO EXPECTED TO SHOW STRONG EXPANSION. THUS IT IS FELT THAT THE JAPANESE ECONOMY WILL BE ABLE TO SUCCESSFULLY MAKE THE TRANSITION TO STEADY, MODERATE GROWTH AS THE ECONOMY EXPANDS FAVORABLY SUPPORTED BY EXPANSION IN PRIVATE-SECTOR AND OTHER DOMESTIC DEMAND ASPECTS TO ACHIEVE REAL ECONOMIC GROWTH IN EXCESS OF 6 PCT PER ANNUM.

QUESTION: HOW DO YOU ASSESS INFLATION MIDWAY THRU 78?
AND WHAT IS THE OUTLOOK FOR SECOND-HALF 78 AND 79?

ANSWER:

1. WHOLESALE PRICES.

WHOLESALE PRICES HAVE BEEN VERY STABLE SINCE LAST YEAR WITH THE EASING OF DOMESTIC SUPPLY-DEMAND, THE YEN-S RAPID APPRECIATION, AND RECESSION IN INTERNATIONAL COMMODITY MARKETS.

LOOKING AHEAD TO SECOND-HALF 78 AND FIRST-HALF 79, SUCH FACTORS IMPLYING HIGHER WHOLESALE PRICES AS (A) RESTORED SUPPLY-DEMAND BALANCE RESULTING FROM DOMESTIC ECONOMIC RECOVERY, (B) THE IMPROBABILITY THAT WE CAN EXPECT FURTHER PRICE BENEFITS FROM CONTINUED RAPID APPRECIATION BY THE YEN, AND (C) THE LIKELIHOOD OF SOME PICKUP IN INTERNATIONAL

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COMMODITY MARKETS ARE IN PART OFFSET BY FACTORS WHICH WILL WORK TO HOLD WHOLESALE PRICES DOWN, FACTORS SUCH AS THE REDUCED IMPORTANCE OF PERSONAL AND OTHER FIXED OVERHEAD EXPENSES AS OPERATING RATIOS IMPROVE. EVALUATING ALL OF THESE FACTORS TOGETHER, IT IS EXPECTED THAT WHOLESALE PRICES WILL RISE FASTER IN JFY 78 THAN THEY DID IN JFY 77, UP AN AVERAGE OF APPROX 2.7 PCT OVER THE YEAR. (BY WAY OF CONTRAST, THE MARCH 78 FIGURE WAS DOWN L.7 PCT FROM THE MARCH 77 LEVEL.)

2. CONSUMER PRICES.

CONSUMER PRICES HAVE BEEN STABLE RECENTLY WITH THE SETTLED WHOLESALE PRICES AND OTHER FACTORS.

LOOKING AHEAD TO SECOND-HALF 78 AND FIRST-HALF 79, IT IS EXPECTED THAT (A) CONSUMER PRICES WILL BE RELATIVELY SLOW-RISING AS A RESULT OF THE STABILITY IN WHOLESALE PRICES (THIS WHOLESALE STABILITY'S HAVING A LAGGED EFFECT ON CONSUMER PRICES), (B) SERVICE CHARGES FOR PERSONAL SERVICES AND THE LIKE WILL REMAIN STABLE, AND (C) THE IMPACT OF UTILITY RATES WILL CONTINUE MODERATE. AS A CONSEQUENCE, CONSUMER PRICES ARE EXPECTED TO BE BASICALLY STABLE, THE AVERAGE RATE OF INCREASE OVER JFY 77 APPROXIMATELY 6.8 PCT.

QUESTION: WHAT ABOUT UNEMPLOYMENT MIDWAY THRU 78, IN SECOND-HALF 78, AND IN 79?

ANSWER:

1. THE UNEMPLOYMENT SITUATION IS VERY SERIOUS, UNEMPLOYMENT STANDING AT 1.36 MIL PEOPLE OR 1.15 MIL SEASONALLY

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ADJUSTED IN FEB 78 (AN INCREASE OF 11.5 PCT OVER THE LEVEL OF FEB 77).

2. NEVERTHELESS, THERE ARE SIGNS OF RECOVERY IN HOURS OF OVERTIME AND THE RATIO OF OPENINGS TO APPLICANTS, BOTH FIGURES CONSIDERED INDICATIVE OF FUTURE EMPLOYMENT TRENDS.

- 76 77 78 78

HOURS OF OVERTIME (MANUFACTURING INDUSTRIES;

1975 EQUALS 100) 131.9 140.0 142.9 143.4

RATIO OF OPENINGS TO APPLICANTS (ALL INDUSTRIES)

0.64 0.56 0.52 0.54

3. WHILE THIS IMPROVEMENT IS THE RESULT OF EXPANSIONARY TENDENCIES IN MINING AND MANUFACTURING INDUSTRIES, THE RATIO OF OPENINGS TO APPLICANTS IS EXPECTED TO FURTHER IMPROVE AND THE EMPLOYMENT SITUATION TO BE ALLEVIATED IN 78 AS FIRMS BECOME MORE POSITIVE ABOUT NEW HIRING IN LIGHT OF ANTICIPATIONS OF MUCH BETTER GROWTH IN JFY 78 THAN IN JFY 77.

4. AS A CONSEQUENCE, THE CURRENT FIGURE FOR UNEMPLOYED WORKERS OF 1.15 MIL IS EXPECTED TO BE REDUCED TO ABOUT 1.10 MIL AVERAGE OVER JFY 78 (FOR AN UNEMPLOYMENT RATE OF APPROX 2 PCT). (IT SHOULD BE BORNE IN MIND, HOWEVER, THAT TRADITIONAL JAPANESE EMPLOYMENT PRACTICES INCLUDE A RELUCTANCE TO LET REDUNDANT WORKERS GO, SUCH

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THAT INDUSTRY CARRIES A CONSIDERABLE NUMBER OF UNDEREMPLOYED WORKERS WHO SHOULD BE CONSIDERED ALONG WITH THIS 2 PCT UNEMPLOYMENT.)

5. ALTHOUGH NO FORECASTS HAVE BEEN DONE YET FOR JFY 79,

IT IS CONSIDERED DESIRABLE FOR JAPAN TO SEEK SUSTAINED GROWTH OF OVER 6 PCT PER ANNUM IN ORDER TO PROMOTE ASSURED EMPLOYMENT STABILITY. IF THIS TARGET IS ACHIEVED, IT IS ANTICIPATED THAT THE EMPLOYMENT SITUATION WILL SHOW CONTINUED IMPROVEMENT IN JFY 79.

QUESTION: WHAT IS THE OUTLOOK FOR JAPAN'S INTERNATIONAL BALANCE OF PAYMENTS MIDWAY THRU 78? FOR SECOND-HALF 78? FOR 79?

ANSWER:

1. ALTHOUGH EXPORTS HAVE BEEN STRONG RECENTLY, THIS IS MAINLY A RESIDUAL STRENGTH AS THE YEN'S APPRECIATION THRU SELF-ADJUSTING FLOATING EXCHANGE RATES HAS YET TO MAKE ITS IMPACT FELT IN EXPORTS, PLUS SUCH SPECIAL EXPORT-PROMOTING FACTORS AS (A) MORE ACTIVE LEAD TRADING IN SECRET

ANTICIPATION OF FURTHER RISES BY THE YEN, (B) AN EXPORT PUSH TO SHORE UP BOTTOM-LINE FIGURES FOR COMPANY ANNUAL REPORTS, AND (C) FEARS OF A U.S. WEST COAST LONGSHOREMEN'S STRIKE
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IN JULY. IMPORTS, ON THE OTHER HAND, REMAIN SLOW AS DOMESTIC PRODUCTION HAS YET TO GET BACK FULLY ON ITS FEET AND AS THE BENEFITS OF THE YEN'S APPRECIATION HAVE YET TO BE UTILIZED. AS A RESULT OF THIS JUXTAPOSITION, THE CURRENT ACCOUNT IS STILL SHOWING CONSIDERABLE SURPLUS, AND IT IS POSSIBLE THIS SITUATION MAY CONTINUE UNTIL MID-78.

2. NEVERTHELESS, EXPORTS ARE EXPECTED TO FALL OFF IN THE LATTER HALF OF THIS YEAR AS THE HIGHER YEN EXCHANGE RATE AFFECTS LESS-PRICE-ELASTIC GOODS. BY THE SAME TOKEN, IMPORTS ARE EXPECTED TO PICK UP WITH THE AGGRESSIVE EXPANSION OF DOMESTIC DEMAND, THE SERIES OF INITIATIVES TAKEN TO LIBERALIZE ACCESS TO JAPANESE MARKETS, AND OTHER LIKE FACTORS. AS A RESULT, IT IS HOPED THERE WILL BE SIGNS OF DIMINUTION IN JAPAN'S CURRENT ACCOUNT SURPLUS BY THIS FALL, AND THIS TREND SHOULD ALSO CONTINUE IN 79.

QUESTION: WHAT ARE THE FISCAL AND MONETARY POLICIES UNDERLYING YOUR ECONOMIC FORECASTS?

ANSWER:

1. FISCAL POLICIES

(1) FOR JFY 78

A. BUDGETARY SCALE OF YEN 34,295 BIL

- GENERAL ACCOUNT GNP GENERAL ACCOUNT/GNP
- (PCT)

JFY 77 YEN 29,346.6 YEN 188,000 15.6

JFY 78 34,295.0 210,600 16.3

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JFY 78 RATE OF
INCREASE OVER

JFY 77 16.9 PCT 12.0 PCT

NOTES: 1. ACCOUNT AND GNP FIGURES ARE IN BIL YEN.

- 2. THE JFY 77 GENERAL ACCOUNT FIGURE INCLUDES BOTH
- SUPPLEMENTAL BUDGETS.

B. MAJOR INCREASE IN INVESTMENT EXPENDITURES

- JFY 77 JFY 78 77-78 RATE OF
- INITIAL INCREASE
- BUDGET

CURRENT EXPENDITURES YEN 22,810.8 YEN 26,783.8 17.4 PCT

INVESTMENT EXPEND. 5,703.5 7,511.2 31.7

TOTAL 28,514.3 34,295.0 20.3

NOTE: FIGURES IN BIL YEN.

C. PROJECT TILT IN GOVERNMENTAL INVESTMENT AND FINANCING
PLANNING

- JFY 77 JFY 78 77-78 RATE
- OF INCREASE

PROJECTS YEN 7,676.9 YEN 9,566.6 24.6 PCT

PUBLIC WORKS

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ORGANIZATIONS	5,325.9	6,421.1	20.6
LOCAL SPENDING	2,351.0	3,145.5	33.8
LOANS	4,861.3	5,321.0	9.5

TOTAL	12,538.2	14,887.6	18.7
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NOTE: FIGURES IN BIL YEN.

THERE HAS BEEN ESPECIALLY STRONG CONCENTRATION ON HOUSING
FINANCE CORPORATION PROVISIONS (UP FROM 387,000 UNITS IN
JFY 77 TO 550,000 UNITS IN JFY 78) TO STIMULATE THE
ECONOMY.

D. MAJOR EXPANSION IN INVESTMENT EXPENDITURES IN LOCAL
GOVERNMENT FINANCIAL PLANNING.

-	JFY 77	JFY 78	77-78 RATE
-			OF INCREASE

LOCAL INVESTMENT YEN 10,038.4 BIL 12,559.4BIL 34.8 PCT

E. TAXATION MEASURES.

THESE INCLUDE BOTH (1) EFFORTS TO INCREASE TAX REVENUES AS
BY UPPING LIQUOR TAXES, IMPOSING AN OIL TAX, ETC. AND (2)
EFFORTS TO REDUCE SELECTED TAXES AS BY INCREASING THE HOME
ACQUISITION DEDUCTION AND ALLOWING A BIGGER TAX CREDIT FOR
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PLANT INVESTMENT.

F. ADVANCED IMPLEMENTATION OF PUBLIC WORKS PROJECTS.

THE TARGET HERE IS TO CONCENTRATE FULLY 73 PCT OF THE
YEAR'S PUBLIC WORKS IN THE FIRST HALF.

(2) FOR JFY 79.

ALTHOUGH IT IS NOT UNLIKELY THAT JFY 79 WILL NEED A STRONG

STIMULATIVE ECONOMIC POLICY AS SUCH DEEMED NECESSARY IN JFY 78, IT IS STILL TOO EARLY TO SPECULATE UPON THE ACTUAL FISCAL POLICIES TO BE TAKEN IN JFY 79. HOWEVER, IF THE JAPANESE ECONOMY PROVES ABLE TO ACCELERATE THE PACE OF RECOVERY, ONE OF THE MORE IMPORTANT ISSUES WILL LIKELY BE THAT OF RESTORING GOVT FINANCES TO A SOUND FOOTING.

2. MONETARY POLICIES.

(1) FOR JFY 78.

SINCE A NUMBER OF MEASURES HAVE BEEN TAKEN RECENTLY TO EASE FINANCING, INCLUDING THE MARCH 78 REDUCTION OF THE OFFICIAL DISCOUNT RATE AND THE SUBSEQUENT LOWERING OF LONG-TERM INTEREST RATES, THE GOVT WILL WORK TO ENSURE THAT THESE MEASURES HAVE THEIR DESIRED IMPACT THROUGHOUT THE ECONOMY IN JFY 78.

(2) FOR JFY 79.

FUTURE MONETARY POLICY WILL BE DETERMINED FLEXIBLY TO RESPOND EFFECTIVELY TO PREVAILING ECONOMIC CONDITIONS.

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UNLESS EVENTS TAKE A QUITE UNEXPECTED TURN, IT IS UNLIKELY THERE WILL BE ANY SHIFT TO TIGHT-MONEY POLICIES AIMED AT CHECKING EXCESSIVE PRICE INCREASES.

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QUESTION: WHAT KIND OF AN INCOMES POLICY UNDERLIES YOUR ECONOMIC FORECASTS?

ANSWER:

1. JAPAN HAS NEITHER IMPLEMENTED AN INCOMES POLICY IN THE PAST NOR EXPECTS TO DO SO IN THE FUTURE.

2. AMONG THE REASONS FOR JAPAN'S AVOIDANCE OF AN INCOMES POLICY MAY BE CITED:

- I. BOTH THE GOVERNMENT AND THE PEOPLE AT LARGE FEEL
- WAGES ARE SOMETHING TO BE DETERMINED INDEPENDENTLY BY
- LABOR AND MANAGEMENT.

- II. WAGES IN JAPAN, AS WELL AS THE PRICES OF GOODS
- AND SERVICES, ARE VERY FLEXIBLE REFLECTING MARKET
- SUPPLY AND DEMAND. FOR EXAMPLE, LOOKING AT THE
- AVERAGE WAGE INCREASES NEGOTIATED DURING THE ANNUAL
- SPRING ROUND, THESE ARE 15.3 PERCENT IN 1972, 20.1
- PERCENT IN 1973, 32.9 PERCENT IN 1974, 13.1 PERCENT
- IN 1975, 8.8 PERCENT IN 1976, AND 8.8 PERCENT IN

- 1977, SHOWING CONSIDERABLE FLUCTUATION WITH CHANGING
- ECONOMIC CONDITIONS.

3. AMONG THE FACTORS ACCOUNTING FOR THIS ARE (I) THE STRONG PUBLIC APPREHENSION ABOUT INFLATION AND (II) LABOR

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PRACTICES PECULIAR TO JAPAN (INCLUDING LIFE-TIME EMPLOYMENT, SENIORITY-BASED WAGES, AND UNIONS ORGANIZED ALONG COMPANY RATHER THAN TRADE LINES).

4. AS A CONSEQUENCE, IT IS FELT MORE APPROPRIATE FOR THE GOVERNMENT TO UTILIZE AGGREGATE-DEMAND-MANAGEMENT POLICIES CENTERING UPON FISCAL AND MONETARY MEASURES TO STABILIZE PRICES, REFLATE THE ECONOMY, AND STABILIZE EMPLOYMENT. IN ADDITION, THE GOVERNMENT IS ALSO TAKING COMPETITION-STIMULATIVE POLICY INITIATIVES AND OTHER MEASURES TO FACILITATE THE SMOOTH WORKING OF MARKET MECHANISMS.

QUESTION: HOW ARE THE ADVANCED INDUSTRIAL NATIONS DOING ECONOMICALLY?

ANSWER:

1. EVEN THOUGH IT IS DIFFICULT TO BE ENTIRELY SATISFIED WITH THE ADVANCED INDUSTRIAL NATIONS' EXPERIENCE OVER THE PAST YEAR IN EMPLOYMENT, PRICES, OR ECONOMIC GROWTH, IT IS FELT THAT THEY HAVE OVERALL FIRMED UP THE BASES FOR INFLATION-FREE, ASSURED GROWTH. TO WIT, A NUMBER OF COUNTRIES HAVE MADE CONSIDERABLE PROGRESS IN RECTIFYING THEIR BALANCE OF PAYMENTS POSITIONS THROUGH EFFORTS FOR ECONOMIC STABILIZATION, AND THERE HAS ALSO BEEN CLEAR PROGRESS MADE IN HOLDING DOWN PRICES.

2. FOR THE FUTURE, IT IS IMPORTANT THAT THESE NATIONS

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MAKE FURTHER EFFORTS TO ACHIEVE ASSURED, INFLATION-FREE GROWTH SUFFICIENT TO ALLEVIATING THE LINGERING HIGH RATES OF UNEMPLOYMENT AND WORK TO RECTIFY INTERNATIONAL BALANCE OF PAYMENTS DISEQUILIBRIUMS AMONG THEMSELVES.

3. IT IS FUNDAMENTAL HERE THAT EACH OF THE ADVANCED INDUSTRIAL NATIONS MAKE EVERY EFFORT TO EXPAND DEMAND WITHOUT REKINDLING INFLATION AND TO RECTIFY BALANCE OF PAYMENTS DISEQUILIBRIUM ACTING AS APPROPRIATE IN VIEW OF THE SITUATION PREVAILING IN THAT NATION, INCLUDING TACKLING THOSE FUNDAMENTAL AND STRUCTURAL PROBLEMS REQUIRING SOLUTION.

4. IF THESE VARIOUS EFFORTS BY THE DIFFERENT NATIONS ARE TO BEAR FRUIT, IT IS OF OVERRIDING IMPORTANCE THAT THE INTERNATIONAL CURRENCY SITUATION BE STABILIZED AND THAT THE FREE-TRADE SYSTEM BE MAINTAINED AND EVEN STRENGTHENED.

QUESTION: WHAT IS THE ECONOMIC OUTLOOK FOR THE DEVELOPING NATIONS?

ANSWER:

1. REALIZING THAT THE NON-OIL DEVELOPING NATIONS FACE SERIOUS PROBLEMS INCLUDING BALANCE OF PAYMENTS DEFICITS AND MOUNTING FOREIGN DEBT OBLIGATIONS AND AWARE OF THE ECONOMIC DIFFICULTIES FACING BOTH INDUSTRIALIZED AND DEVELOPING NATIONS, JAPAN'S BASIC ATTITUDE TOWARD ECONOMIC MANAGEMENT IN JFY 1978 CALLED UPON JAPAN TO REDOUBLE ITS EFFORTS FOR INTERNATIONAL HARMONY.

2. ALTHOUGH THERE ARE HOPES FOR CONSPICUOUS GROWTH IN PRE-CAPITA GNP IN THE NATIONS OF EAST ASIA AND LATIN AMERICA, THE NATIONS OF SOUTH ASIA AND AFRICA CONTINUE TO
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SUFFER FROM SLOW GROWTH.

3. LOOKING AT THE ECONOMIC FORECASTS MADE BY THE GOVERNMENTS OF THE MAIN ASIAN NATIONS, MOST OF THESE NATIONS ANTICIPATE A RATE OF ECONOMIC GROWTH IN 1978 EQUAL TO OR JUST SLIGHTLY UNDER THAT ACHIEVED IN 1977. THIS OUTLOOK IS BASED PRIMARILY ON THE LIKELIHOOD THAT THEIR EXPORTS WILL EXPAND MORE SLOWLY THAN IN 1977 SINCE (1) THE ADVANCED INDUSTRIAL NATIONS' ECONOMIC RECOVERY IS STILL

AILING AND (II) STIFFER IMPORT RESTRICTIONS ARE EXPECTED FROM THE EC AND OTHER IMPORTANT MARKETS. AS A CONSEQUENCE, THESE DEVELOPING NATIONS PLAN TO PUT THEIR POLICY EMPHASIS ON STIMULATING DOMESTIC DEMAND.

4. BY WAY OF REFERENCE, OECD ECONOMIC OUTLOOK FIGURES ARE GIVEN BELOW.

- 1970-73 1973 1974 1975 1976 1977 1978
- AVERAGE

CURRENT ACCOUNTS (EXCLUDING OFFICIAL TRANSFERS)

OECD 11-1/4 11-1/2 -22 6-1/2 -13-1/4 -18-1/4 -8

OPEC 4 9 63-1/4 32-1/4 44-1/4 42-1/2 38

NON-

OIL

LDCS 13 -14-1/4 -33-1/4 -50-1/2 -36-3/4 -33-1/2 -45-1/2

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FM AMEMBASSY TOKYO

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CURRENT ACCOUNTS (EXCLUDING OFFICIAL TRANSFERS)

OECD 4-1/4 2-3/4 -32-3/4 -6-1/4 -26-1/2 -32 -22-1/2

OPEC 4 9 61-3/4 30-3/4 42-1/4 40 35

NON-

OIL

LDCS 7-3/4 -8 -24-1/2 -40 -26-1/4 -22-1/2 -33-1/2

OTHERS

3 -5-1/2 -9-3/4 -18 -13-1/4 -11-1/4 -11-1/2

NOTES: 1. THE 1970-73 AVERAGE IS A SIMPLE AVERAGE FOR THE
- FIGURES FOR THESE YEARS.

- 2. VALUES ARE IN BILLION (10.9) DOLLARS.

QUESTION: WHAT ARE THE ECONOMIC AND POLITICAL CONSTRAINTS
WHICH WOULD INHIBIT A PUSH FOR FASTER GROWTH?

ANSWER: JAPAN IS SEEKING TO ACHIEVE STABLE GROWTH AND
BALANCED ECONOMIC DEVELOPMENT, AND IT IS FEARED THAT ANY
EFFORT TO ACHIEVE A GROWTH RATE IN EXCESS OF THE GOVERN-
MENT'S 7 PERCENT TARGET MIGHT INVITE A REKINDLING OF
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INFLATION. IN ADDITION, THERE ARE ALSO A NUMBER OF
FISCAL AND MONETARY CONSTRAINTS TO SEEKING FASTER-THAN-
TARGETED GROWTH.

1. FISCAL CONSTRAINTS

- I. THE JAPANESE DEPENDENCE UPON GOVERNMENT BOND
ISSUES IS MUCH HIGHER THAN IN OTHER NATIONS BECAUSE JAPAN
HAS HAD TO CONDUCT MASSIVE ISSUES SINCE 1975 TO OFFSET
THE SLUGGISH GROWTH IN TAX REVENUES AND FOR OTHER REASONS.

- II. EVEN WITHIN THIS HEAVY DEPENDENCE UPON BOND
ISSUES, THERE IS ESPECIALLY HEAVY RELIANCE UPON SPECIAL
BONDS TO FINANCE PERSONNEL COSTS AND OTHER SUCH CURRENT-
ACCOUNT ITEMS WHICH DO NOT RESULT IN THE CREATION OF
TANGIBLE ASSETS.

- III. PRELIMINARY PROJECTIONS OF THE GOVERNMENT'S
FINANCIAL BALANCE INDICATE THAT, DEPENDING UPON HOW
GREATLY DISBURSEMENTS CAN BE CURTAILED, IT WILL BE
NECESSARY TO PROCURE ADDITIONAL TAX REVENUES TOTALLING BE-
TWEEN YEN 5 - 10 TRILLION (10.12) IN THE JFY 1979-82
PERIOD IF JAPAN IS TO CURE ITS DEPENDENCE UPON SUCH
SPECIAL BOND ISSUES BY JFY 1982.

- IV. TO EXPAND DEFICIT SPENDING UNDER CURRENT
CONDITIONS WOULD (A) LEAD TO AN UNCHECKED BLOATING IN
GOVERNMENT SPENDING POSSIBLY GENERATING SERIOUS INFLATION,
(B) INCUR A HEAVIER SERVICE BURDEN FOR THESE GOVERNMENT
BONDS AND THUS MAKE IT STILL MORE DIFFICULT TO RESTORE
SOUND FINANCIAL PRACTICES AND TO IMPLEMENT THOSE POLICIES
TRULY IN THE BROAD PUBLIC INTEREST, AND (C) GENERATE,
DEPENDING UPON FUTURE ECONOMIC DEVELOPMENTS, CROWDING-
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OUT AND OTHER PROBLEMS IN REDEEMING THE VAST VOLUME OF
GOVERNMENT BONDS OUTSTANDING.

2. MONETARY CONSTRAINTS

EVEN IF THE OFFICIAL DISCOUNT RATE IS LOWERED STILL FURTHER,
THE FINANCIAL INSTITUTIONS' BUSINESS POSITIONS, THE NEED
TO MAINTAIN ATTRACTIVE INTEREST RATES FOR SAVINGS ACCOUNTS,
AND OTHER PROBLEMS MAKE IT UNLIKELY THAT THIS WOULD BE
REFLECTED IN A COMMENSURATE REDUCTION IN LENDING INTEREST
RATES.

3. NEED FOR CURRENCY EXCHANGE STABILIZATION

INTERNATIONAL EXCHANGE STABILIZATION FOR THE YEN AND
OTHER CURRENCIES IS PREREQUISITE TO THE ATTAINING OF
ECONOMIC FORECASTS AND TARGETS.

- THE JAPANESE ECONOMY CAN NOT HELP BEING AFFECTED BY
INTERNATIONAL ECONOMIC FLUCTUATIONS IN TODAY'S HIGHLY
INTERDEPENDENT GLOBAL ECONOMY, YET IT SHOULD GO WITHOUT
SAYING THAT THE GOVERNMENT'S ECONOMIC FORECASTS AND
TARGETS ARE NECESSARILY PREMISED UPON THE ASSUMPTION OF
REASONABLE STABILITY IN CURRENCY EXCHANGE AND OTHER BASIC
INTERNATIONAL ECONOMIC ASPECTS. (FOR EXAMPLE, THE YEN'S
ABRUPT APPRECIATION WAS A MAJOR FACTOR FORCING THE
GOVERNMENT TO REVISE ITS JFY 1977 REAL ECONOMIC GROWTH
RATE OF 6.7 PERCENT DOWNWARD.)

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QUESTION: WHAT IS THE OUTLOOK FOR PLANT INVESTMENT?
WHAT ARE THE IMPEDIMENTS TO PLANT INVESTMENT? ETC.

ANSWER:

L. OUTLOOK FOR JFY 1978 AND BEYOND

ACCORDING TO RECENT BUSINESS SURVEYS BY PRIVATE INSTITUTIONS OF THE BIG COMPANIES' PLANS FOR PLANT INVESTMENT IN JFY 1978, A 9 - 10 PERCENT INCREMENT IS EXPECTED CENTERING UPON (A) INVESTMENT BY THE ELECTRICAL POWER COMPANIES TO ENSURE LONG-TERM SUPPLY CAPACITIES, (B) INVESTMENT BY PETROLEUM COMPANIES SEEKING RAPID IMPROVEMENT IN THEIR STORAGE AND SAFETY FACILITIES, AND (C) INVESTMENT BY SUCH TERTIARY-SECTOR INDUSTRIES AS WHOLESALING, RETAILING, AND LEASING. SMALL AND MEDIUM-SIZED FIRMS ARE ALSO EXPECTED TO FOLLOW SUIT WITH SIMILAR INVESTMENT INCREMENTS, SUCH THAT IT WILL THUS BE POSSIBLE TO MEET THE GOVERNMENT'S TARGET-FORECAST FOR JFY 1978.

THE INVESTMENT CLIMATE IS EXPECTED TO BE EVEN BETTER IN JFY 1979 AS PRIVATE-SECTOR DEMAND PICKS UP STILL FURTHER, OPERATING RATIOS ARE IMPROVED, INVENTORY ADJUSTMENTS ARE EFFECTED, AND THE ECONOMY IS OTHERWISE RESTORED TO HEALTH, INCLUDING THE BENEFITS OF POLICY MEASURES TAKEN TO AID STRUCTURALLY DEPRESSED INDUSTRIES.

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2. IMPEDIMENTS TO EXPANSION OF PLANT INVESTMENT

I. SHORT-TERM IMPEDIMENTS TO PLANT INVESTMENT EXPANSION

A. FIRST IS THE SLUGGISH AGGREGATE DEMAND AND THE EXISTENCE OF EXCESS SUPPLY CAPACITY. AGGREGATE DEMAND IS ESPECIALLY SLUGGISH IN THE PRIVATE PLANT INVESTMENT AND HOUSING INVESTMENT SECTORS WHICH ARE PARTICULARLY EFFECTIVE IN GENERATING INDUCED INVESTMENT.

B. ALSO TO BE CONSIDERED IS THE INCREASED COST OF INVESTMENT AS A RESULT OF THE OIL CRISIS. ALTHOUGH SOME PROGRESS HAS BEEN MADE IN ESTABLISHING A NEW PRICE STRUCTURE COMMENSURATE WITH CONDITIONS SUBSEQUENT TO THE OIL CRISIS, THERE ARE STILL PROBLEMS IN ADJUSTING THIS STRUCTURE TO TAKE ACCOUNT OF HIGHER INVESTMENT COSTS.

II. MEDIUM- AND LONG-TERM STRUCTURAL CHANGES IN THE JAPANESE ECONOMY IMPEDING PLANT INVESTMENT

A. THE LULL IN TECHNOLOGICAL INNOVATION AND THE ABSENCE

OF PROMISING GROWTH PRODUCTS FOR THE FUTURE.

B. INCREASING UNCERTAINTY ABOUT THE GLOBAL ECONOMIC
OUTLOOK.

C. ANXIETY OVER RAW MATERIAL AND ENERGY SUPPLY CONSTRAINS.

D. ENVIRONMENTAL CONCERN AND RESULTANT STRONG PUBLIC
RESISTANCE TO POSSIBLY HARMFUL INDUSTRIAL PLANTS.

3. POLICIES TO STIMULATE PLANT INVESTMENT

I. THE FOLLOWING MEASURES ARE BEING IMPLEMENTED IN
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JFY 1978 TO ALLEVIATE SHORT-TERM IMPEDIMENTS AND TO
STIMULATE INCREASED PLANT INVESTMENT.

A. EXPANSION OF AGGREGATE DEMAND

BECAUSE OF THE LACK OF DEMAND IS THE BIGGEST REASON FOR
THIS SLUGGISHNESS IN PLANT INVESTMENT, GOVERNMENT FISCAL
POLICIES TO EXPAND AGGREGATE DEMAND ARE VERY IMPORTANT FOR
STIMULATING PLANT INVESTMENT. ACCORDINGLY, THE GOVERNMENT
HAS EMBARKED UPON AN AMBITIOUS PROGRAM OF TREASURY DIS-
BURSEMENTS CENTERING UPON PUBLIC WORKS PROJECTS TO ASSURE
ATTAINMENT OF THE TARGETED 7 PERCENT RATE FOR JFY 1978.

B. TAX CREDITS AND OTHER POLICIES TO STIMULATE PLANT
INVESTMENT.

AMONG THE POLICIES IMPLEMENTED TO REDUCE THE COSTS OF,
INVESTING AND TO FACILITATE PLANT INVESTMENT EXPANSION
ARE (I) A TAX CREDIT FOR SMALL AND MEDIUM-SIZED FIRMS
INVESTING IN NEW PLANT OR ANTI-POLLUTION FACILITIES,
(II) INCREASED GRANTS FROM THE NATIONAL TO LOCAL GOVERN-
MENTS TO FACILITATE SITE ACQUISITION FOR ELECTRICAL POWER
GENERATING PLANTS, (III) INCREASED GRANTS FROM THE NATIONAL
TO LOCAL GOVERNMENTS TO FACILITATE SITE ACQUISITION FOR
PETROLEUM STORAGE FACILITIES, AND (IV) ACCELERATED ORDERS
FOR THE ELECTRICAL POWER INDUSTRY.

II. A NUMBER OF MEASURES ARE ALSO PLANNED OR UNDER WAY
TO ALLEVIATE LONGER-TERM IMPEDIMENTS TO

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INCREASING PLANT INVESTMENT. PRIMARY AMONG THESE ARE
EFFORTS TO PROMOTE INTERNATIONAL HARMONY AND TO LESSEN
THE AREAS OF UNCERTAINTY SUCH AS BY SEEKING ST-BILIZATION
OF INTERNATIONAL CURRENCY EXCHANGE RATES, TO ALLEVIATING
BUSINESS FOREBODINGS OVER THE GLOBAL ECONOMIC SITUATION,
AND TO EXPAND INVESTMENT OPPORTUNITIES BY PROMOTING
CONTINUED TECHNOLOGICAL DEVELOPMENT.

4. IMPACT OF EXPANDED PLANT INVESTMENT UPON DEMAND AND
SUPPLY CAPACITY
BECAUSE THE INCREASE IN PLANT INVESTMENT IN JFY 1978 IS
EXPECTED TO CENTER UPON SUCH NON-MANUFACTURING SECTORS AS
THE ELECTRICAL POWER AND SERVICE INDUSTRIES, IT IS
FELT THE DEMAND THUS GENERATED WILL CONTRIBUTE SUBSTANT-
IALLY TO ALLEVIATING THE DOMESTIC EXCESS SUPPLY POSITION.
AT THE SAME TIME, IN THE FACE OF THIS ADVERSE SUPPLY-
DEMAND GAP, MANUFACTURING INDUSTRIES ARE EXPECTED TO
IVNEST LESS IN PLANT AND EQUIPMENT THAN THEY DID IN
JFY 1977, SUCH THAT THERE WILL THUS BE LITTLE
ADDITIONAL SUPPLY CAPACITY GENERATED.

QUESTION: HOW DO INDUSTRY OPERATING RATIO TRENDS LOOK?

ANSWER:

L. THE INDUSTRIAL OPERATING INDEX (WHICH SHOWS THE
RATIO OF CAPACITY BEING UTILIZED IN COMPARISON WITH THE
LEVEL IN THE BASE YEAR OF 1975 ASSIGNED A VALUE OF
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100) REACHED A HIGH OF 109.9 IN MARCH 1977 BUT SUBSEQUENTLY
FELL FOR FOUR STRAIGHT MONTHS AFTER THAT. HOWEVER, AFTER
CONTINUING SLUGGISH UNTIL OCTOBER, IT HAS SINCE
RECOVERED TO REGAIN THE 109.0 LEVEL IN FEBRUARY 1978.
BECAUSE IT IS EXPECTED THAT MINING AND MANUFACTURING

PRODUCTION LEVELS WILL IMPROVE AS DEMAND INCREASES, THIS
OPERATING INDEX IS ALSO EXPECTED TO SHOW FURTHER
IMPROVEMENT.

2. LOOKING AT THE INDUSTRIAL PRODUCTION CAPACITY INDEX
(ALSO TAKING 1975 AS THE BASE YEAR OF 100), THIS
SHOULD ONLY SLOW GROWTH IN 1975 AND 1976, YET THE RATE OF
INCREASE HAS PICKED UP SOMEWHAT SINCE FIRST-HALF 1977.

LOOKING AT CAPITAL STOCK (IN CONSTANT 1970 PRICES), THE
RATE OF INCREASE HAD SLOWED EVERY YEAR SINCE 1974, YET
HAS HSOWN SOME IMPROVEMENT SINCE EARLY 1977. ALTHOUGH
THERE HAS BEEN SOME DISCREPANCY BETWEEN THE PRODUCTION
CAPACITY AND CAPITAL STOCK INDICES, THIS IS ATTRIBUTABLE
TO THE VERY HEAVY INVESTMENT IN ANTI-POLLUTION
FACILITIES IN THE 1974-76 PERIOD, SUCH THAT INCREASED
CAPITAL STOCK DID NOT NECESSARILY MEAN INCREASED
PRODUCTION CAPACITY.

- 1973 1974 1975 1976 1977

OPERATING RATIO INDEX 91.7 97.8 100.0 102. 106.4
(COMPARED TO PREVIOUS N.A. 6.7 2.2 2.8 3.5
QUARTER)

PRODUCTION CAPAC.INDEX 94.5 99.5 101.2 104.3 107.0
(COMPARED TO SAME N.A. 5.3 L.7 3.1 2.6
QUARTER OF PREV. YEAR)

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CAPITAL STOCK 52167 56731 60121 63073
(COMPARED TO SAME 10.0 8.7 6.0 4.9
QUARTER OF PREV. YEAR)

TABLE CONTINUED

- 1977 1978

- 1ST 2ND 3RD 4TH

-- QTR QTR QTR JAN. FEB.

OPERATING RATIO INDEX 109.9 108.0 106.5 106.5 109.4 109.0
(COMPARED TO PREVIOUS 0.5 -L.7 -L.4 0 L.L -0.4
QUARTER)

PRODUCTION CAPAC.INDEX 105.6 106.3 107.0 107.0 107.0 107.L
(COMPARED TO SAME 3.5 3.7 3.6 2.6 L.5 1.6
QUARTER OF PREV. YEAR)

CAPITAL STOCK 64254 64779 65693
(COMPARED TO SAME 5.8 5.8 5.3
QUARTER OF PREV. YEAR)

NOTE: L. BASE YEARS (100) FOR BOTH THE OPERATING RATIO
INDEX AND THE PRODUCTION CAPACITY INDEX ARE 1975.

2. BOTH PRODUCTION CAPACITY INDEX AND CAPITAL STOCK
FIGURES ARE AS OF THE END OF THE PERIOD.

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TO SECSTATE WASHDC IMMEDIATE 7551

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3. CAPITAL STOCK VALUES ARE IN BILLION YEN.
RATIO OF ANTI-POLLUTION INVESTMENT TO ALL PLANT INVESTMENT

1970 - 5.3 PERCENT, 1971 - 6.5 PERCENT, 1972 - 8.3 PERCENT,
1973 - 9.8 PERCENT, 1974 - 13.4 PERCENT,
1975 - 17.1 PERCENT, 1976 - 15.2 PERCENT, 1977 - 9.5
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Message Attributes

Automatic Decaptioning: Z
Capture Date: 01 jan 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: ECONOMIC COOPERATION, PLANNING MEETINGS, SUMMIT MEETINGS
Control Number: n/a
Copy: SINGLE
Draft Date: 28 apr 1978
Decaption Date: 20 Mar 2014
Decaption Note: 25 YEAR REVIEW
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 20 Mar 2014
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1978TOKYO07733
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Expiration:
Film Number: D780181-1221
Format: TEL
From: TOKYO
Handling Restrictions:
Image Path:
ISecure: 1
Legacy Key: link1978/newtext/t1978043/aaaaabvl.tel
Line Count: 1020
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: a22954a9-c288-dd11-92da-001cc4696bcc
Office: ACTION SS
Original Classification: SECRET
Original Handling Restrictions: EXDIS
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 19
Previous Channel Indicators: n/a
Previous Classification: SECRET
Previous Handling Restrictions: EXDIS
Reference: 78 TOKYO 7370
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 10 may 2005
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 2886199
Secure: OPEN
Status: NATIVE
Subject: BONN SUMMIT PREPARATIONS
TAGS: ECON, OCON
To: STATE
Type: TE
vdkgvwkey: odbc://SAS/SAS.dbo.SAS_Docs/a22954a9-c288-dd11-92da-001cc4696bcc
Review Markings:
Sheryl P. Walter
Declassified/Released
US Department of State
EO Systematic Review
20 Mar 2014
Markings: Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014